

## **FAIR AND EQUITABLE TREATMENT OF FOREIGN INVESTMENTS**

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### **Abstract in original language**

Fair and equitable treatment is one the treatment standards we can regularly find in bilateral investment treaties on reciprocal encouragement and protection of foreign investments. However, these treaties do not provide any specific definition of the content of this standard of treatment. The purpose of this paper is to provide the reader with a brief survey of the case law on this matter and thus with a better understanding of what is currently perceived as "fair and equitable treatment" of foreign investments.

### **Key words in original language**

Mezinárodní investice, mezinárodní investor, hostitelský stát, režimy zacházení

### **Abstract**

Režim spravedlivého a rovnoprávného zacházení je jeden z režimů zacházení pravidelně se objevujících ve dvoustranných dohodách o vzájemné podpoře a ochraně investic. Tyto dohody však jasně neodpovídají na otázku, co je konkrétním obsahem tohoto režimu. Cílem tohoto příspěvku je proto poskytnou čtenáři stručný náhled do judikatury zabývající se touto problematikou a přispět tak k upřesnění definičního rozsahu tohoto režimu zacházení s mezinárodními investicemi.

### **Key words**

Foreign investments; foreign investor; host state; standards of treatment; fair and equitable standard of treatment

### **Introduction**

After the big political changes brought about by democratic revolutions in Central and Eastern Europe in the end of 1989, the new born democracies realized they needed a huge amount of capital in order to boost their nascent market oriented economy. One way of obtaining the needed financial resources was to attract investments from abroad. Foreign investors would, however, not have been willing to invest in these territories unless they felt their capital was dully protected against potential losses brought about by states' measures. In order to create a favourable climate for the flow of foreign investments, these countries began adjusting their legal systems to

correspond to requirements of potential international investors. They have not only worked on their internal laws but at the same time kept concluding bilateral international treaties on encouragement and reciprocal protection of investments with other states and also accessing to multilateral investment treaties. The main purpose of these treaties is to provide the foreign investors with legal guarantees securing that their property placed in the host state will not be harmed. The heart of the legal protection of foreign investments lies currently in the bilateral treaties on encouragement and reciprocal protection of investments ("BITs) which among other things provide the investor the right to be accorded "fair and equitable standard of treatment" of his investment. However, as it will be shown, the bilateral treaties do not provide any definition as to what is the content of this standard of treatment. The jurisprudence of international tribunals and the writing of highly qualified scholars are eminent for determining this content and thus shedding light on the meaning of this ambiguous phrase. The purpose of this paper is to provide the reader with a brief survey of the case law on this matter and thus with a better understanding of what is currently perceived as "fair and equitable treatment" of foreign investments<sup>1</sup>.

## 1. Fair and equitable standard of treatment in BITs

Regardless of whether the entry of a foreign investment requires special permission of the host state, it is guaranteed principally by all bilateral investment treaties so called "fair and equitable" standard of treatment. Besides national treatment, minimum international standard of treatment, most-favoured nation treatment, and guarantee to receive full protection and security, basically all BITs also contain this standard of treatment. Despite the fact that treaties refer to this standard, its content is far from being clear. Sornarajah writes that: "this phrase is vague and is open to different interpretations". He also admits that the content of this treatment has been causing much anxiety<sup>2</sup>. Some BITs contain this standard in a separate provision, other mention them in a combination with other standards of treatment. Norwegian model BIT<sup>3</sup> for example states in its Article 5 that "each Party shall accord to investors of the other Party, and their investments treatment in accordance with customary international law, including fair and equitable treatment and full protection and security.

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<sup>1</sup> The tribunal, dealing with the case *CME v. the Czech Republic*, decided that the Czech Republic was in breach of this treatment standard. *CME v. the Czech Republic* (2002) UNCITRAL Arbitral Tribunal, final award 14 March 2003. Its breach was also alleged in the case *Saluka v. Czech Republic* (2006), *Saluka Investments BV (The Netherlands) v. the Czech Republic*, Partial Award (2006)

<sup>2</sup> Sornarajah, M., *The International Law on Foreign Investment*, 2nd ed., Cambridge University Press, 2004, str. 235 – 236.

<sup>3</sup> Norway 2007 Draft Model BIT can be found at: <http://ita.law.uvic.ca/documents/NorwayModel2007.doc>

Current US Model BIT<sup>4</sup> contains a very elaborate provision on fair and equitable treatment in its Article 5 which is called "Minimum standard of treatment". This model treaty states that: "each Party shall accord to covered investments treatment in accordance with customary international law, including fair and equitable treatment and full protection and security. Second paragraph further specifies that the concept of "fair and equitable treatment" does not require treatment in addition to or beyond that which is required by customary international law minimum standard and does not create additional substantive rights. The obligation to provide "fair and equitable treatment" includes the obligation not to deny justice in criminal, civil, or administrative adjudicatory proceedings in accordance with the principle of due process embodied in the principle legal systems of the world. Similar provision, though not that precise and elaborate as the American one, can be found in Article 5 of the Canadian Model BIT<sup>5</sup>. It states: "each Party shall accord to covered investments treatment in accordance with the customary international law minimum standard of treatment of aliens including fair and equitable treatment and full protection and security. It further states that the concept of "fair and equitable treatment" does not require treatment in addition to or beyond that which is required by the customary international law minimum standard of treatment of aliens. The BIT concluded between former Czechoslovakia and the Kingdom of Netherlands embodies this right in its Article 3(14) as the right of investor of the other party to impartial and equitable treatment. As can be inferred from these examples, the fair and equitable standard of treatment is usually covered by a more general standard, namely the minimum international standard of treatment which is the standard provided by customary international law.

Regardless of the exact wording of these provisions their content is unclear and opened to different interpretations. Despite the vagueness of the content as appears in the treaties, it is nevertheless possible to provide a more specific definition of this standard of treatment by observing its interpretation provided by arbitral tribunals which were dealing with it while deciding a specific case.

## **2. Fair and equitable standard of treatment in arbitral awards**

In the *Mondev* case<sup>6</sup> the tribunal held that the decision on what is fair and equitable cannot be reached in abstract but must always depend on the fact of the particular case. In *Saluka v. the Czech Republic*<sup>7</sup>, the tribunal based

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<sup>4</sup> US 2004 Model BIT , available at: <http://ita.law.uvic.ca/documents/USmodelbitnov04.pdf>

<sup>5</sup> Canada 2004 Model BIT, available at: <http://ita.law.uvic.ca/documents/Canadian2004-FIPA-model-en.pdf>

<sup>6</sup> *Mondev International Ltd. v. United States of America*, ICSID č. ARB(AF)/99/2

<sup>7</sup> *Saluka Investments BV (The Netherlands) v. the Czech Republic*, Partial Award (2006)

the interpretation of this standard on the interpretation rules contained in the Vienna Convention on the Law of Treaties<sup>8</sup>. Article 31(1) of this Treaty states that "*a treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose.*"

The tribunal deciding the MTD case<sup>9</sup> stated that "under the BIT in question, the fair and equitable standard of treatment has to be interpreted in the manner most conducive to fulfill the objective to protect investments and create conditions favourable to investments"<sup>10</sup>. Using the definition provided by the Concise Oxford Dictionary of Current English, this tribunal recalled that in their ordinary meaning the terms "fair" and "equitable" mean "just", "even-handed", "unbiased", "legitimate". The Tribunal concluded that in the terms of the BIT, fair and equitable treatment should be understood to be treatment in an even-handed and just manner, conducive to fostering the promotion of foreign investment<sup>11</sup>.

In S. D. Myers case<sup>12</sup>, the tribunal took the view that a breach of Article 1105 NAFTA<sup>13</sup> occurs only when it is shown that the treatment rises to the level that is unacceptable from the international perspective<sup>14</sup>.

As far as the context in which these terms should be interpreted, there is direct link of the standard of treatment with other provisions of a particular treaty including its preamble, in which the fair and equitable treatment is directly linked with the stimulation of foreign investments and the economic development of the contracting Parties. In fact, the subject and the purpose of investment treaties can be seen already in the title of the treaties (*Treaties on Encouragement and Reciprocal Protection of Investment*) as well as from their preambles (...*The Government of the United States of America and the Government of [Country] (hereinafter the "Parties")*); *Desiring to promote greater economic cooperation between them with respect to investment by nationals and enterprises of one Party in the territory of the*

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<sup>8</sup> The Vienna Convention on the Law of Treaties is available at: [http://untreaty.un.org/ilc/texts/instruments/english/conventions/1\\_1\\_1969.pdf](http://untreaty.un.org/ilc/texts/instruments/english/conventions/1_1_1969.pdf)

<sup>9</sup> MTD Equity, ICSID č. ARB/01/7

<sup>10</sup> MTD Equity, ICSID č. ARB/01/7, para. 104

<sup>11</sup> MTD Equity, ICSID č. ARB/01/7, para. 113

<sup>12</sup> S. D. Myers, Inc., 40 ILM 1408, para. 263

<sup>13</sup> ... which also contains the obligation to provide fair and equitable treatment.

<sup>14</sup> However, it also stated that the phrases "fair and equitable" and "full protection and security" cannot be read in isolation. They must be read in conjunction with the introductory phrase "treatment in accordance with international law". S. D. Myers, Inc., 40 ILM 1408, para. 262

*other Party*)<sup>15</sup>. The protection of investment is not the sole purpose of these treaties but rather an element of the overall purpose which is to extend and strengthen mutual economic relations. The tribunal, however, stressed in this context that the interpretation of the provisions of the investment treaties has to be balanced. An interpretation which exceedingly emphasizes the investment protection may serve as a discouragement of the host states from accepting foreign investment and therefore undermines the main goal which is to extend and intensify economic relations between the countries. Therefore "the Fair and equitable" treatment shall be understood in this light as a treatment which even if does not directly stimulate the flow of foreign investment capital, it at least does not discourage it by creating obstacles.

This standard of treatment is also closely connected with the notion of "legitimate expectations" of a foreign investor that the conduct of the state, after the entry of his investment, will be fair and equitable. The Tribunal deciding the case *Saluka v. the Czech Republic* thus stated that under the provision of Article 3.1 of the BIT concluded between the Kingdom of Netherlands and the Czech Republic, the Parties assumed an obligation to treat foreign investor so as to avoid the frustration of investor's legitimate and reasonable expectations. The tribunal however observed in this context that if the mentioned terms were to be taken too literally, they would impose upon host States' obligations which would be inappropriate and unrealistic. Moreover, the scope of the Treaty's protection of foreign investment against unfair and inequitable treatment cannot exclusively be determined by foreign investors' subjective motivations and considerations. Their expectations, in order for them to be protected, must rise to the level of legitimacy and reasonableness in light of the circumstances<sup>16</sup>.

In the case *Saluka v. the Czech Republic*, the tribunal concluded that the "fair and equitable treatment" standard is an autonomous Treaty standard and must be interpreted, in light of the object and purpose of the Treaty, so as to avoid conduct that clearly provides disincentives to foreign investors.

## **Conclusion**

As can be seen from the above written it is the international investment tribunals which are bringing the standard of fair and equitable treatment to life. What we can infer from the jurisprudence of these tribunals is that this treatment standard must not be interpreted in isolation but only in a wider

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<sup>15</sup> Excerpt of the US 2004 Model BIT's preamble.

<sup>16</sup> *Saluka Investments BV (The Netherlands) v. the Czech Republic, Partial Award (2006)*, para 304, "No investor may reasonably expect that the circumstances prevailing at the time the investment is made remain totally unchanged. In order to determine whether frustration of the foreign investor's expectations was justified and reasonable, the host State's legitimate right subsequently to regulate domestic matters in the public interest must be taken into consideration as well". Para 305

context of the object and purpose of an investment treaty. The just interpretation and application of this standard of treatment is by no means an easy task. It depends on the circumstances of a particular case but also on the quality and objectivity of arbitrators taking the decision.

I would like to conclude by saying that it is necessary for the States which decided to accept the above mentioned international obligations to bear in mind throughout the whole investment operation the big responsibility, they have assumed. These countries should never forget that by accepting an international obligation, they have not exhausted the international protection they are due to afford and that they are obliged to promote it in practice. The breach of these obligations may lead to an international arbitration and to the punishment of the perpetrating State. The price paid for such a breach can be then very high.

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